

United States  
Circuit Court of Appeals  
For the Ninth Circuit

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C. A. RASMUSSEN, as Collector of Internal Revenue  
for the District of Montana,  
Appellant,

vs.

EDDY'S STEAM BAKERY, INC., a Corporation,  
Appellee.

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Brief of Appellee

UPON APPEAL FROM THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT  
OF MONTANA.

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T. B. WEIR  
HARRY P. BENNETT

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No. 6537

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## STATEMENT OF THE CASE

Inasmuch as this appeal presents the question of whether or not there is evidence to support the court's finding and judgment that Eddy's Steam Bakery, Inc., had no taxable income or profits for the year 1921, we deem it helpful to supplement appellant's statement of the case by reference to that evidence contained in the record.

By his 60 day letter dated February 9, 1926, (T. 8) the Commissioner of Internal Revenue made a deficiency assessment of income tax against the appellee corporation for the year 1921 of \$3,037.41, and found an over-assessment for the year 1922 of \$219.71, and thereafter the Collector, Rasmusson, demanded of the appellee corporation the payment of \$2,817.70, with interest, which aggregate amount of \$3,819.63 was on November 19, 1926, paid by appellee to the appellant Collector, under protest, and thereafter on March 6, 1929, appellee filed its claim of refund with the Collector (T. 15), which claim was denied by the Commissioner of Internal Revenue (T. 15, 21) July 12, 1929, and this action was commenced in the District Court of the United States for the District of Montana, July 29, 1929, (T. 21).

The trial was had to court below without jury and the court found for the appellee corporation and judgment was so entered in the sum of \$3,819.63 February 11, 1931, (T. 73).

From 1910 E. H. Gallivan and J. E. O'Connell were copartners conducting a restaurant at Helena, Montana; in 1916 the copartnership also entered the bakery business at Helena, Montana, (Tr. 28). February 21, 1918, the appellee corporation was formed under the laws of Montana with the corporate name "O'Connell and Gallivan Company," to take over the partnership business in the restaurant and bakery, which it conducted until the latter part of the year 1920 (T. 2, 22, 28).

In September of 1920 Gallivan and O'Connell, who owned all the stock of the corporation (save one share held by O'Connell's brother), (T. 36, 37), apparently decided to end their business relationship, and O'Connell bought Gallivan's stock in the corporation (T. 63). There was then on September 27, 1920, a special meeting of the board of directors, at which Gallivan resigned his offices of President and Director of the corporation (T. 32), and with J. E. O'Connell then owning all the capital stock of the corporation (save one share held by each his brother and his wife) the directors resolved to sell the restaurant business to J. E. O'Connell (T. 33), and thereafter in 1920 J. E. O'Connell as an individual sold the restaurant business to Gallivan (T. 30).

For the next 90 days the bakery business was continued to be owned and run by the corporation, and on January 1, 1921, the directors of the corporation met as a board and resolved to accept the "pro-

posal from Mr. J. E. O'Connell that he be allowed to purchase the assets, good will, trade name, etc., of the O'Connell & Gallivan Company, at book value as of December 31, 1920, and that he would assume any and all outstanding liabilities of the Company that existed at the time". (Tr. 36.) And on the same day the stockholders held a special meeting and ratified the "action of the Board of Directors in disposing of the assets of the corporation to Mr. J. E. O'Connell be confirmed." (Tr. 37, 38.) From that time forward during the year 1921 J. E. O'Connell individually conducted the bakery business (T. 28, 29). He personally held title to the bakery. The bakery was held during all this time under contract of sale and purchase running from Kaufman and Stadler to E. H. Gallivan and J. E. O'Connell as individuals (Plff. Ex. 2), which contract eventuated in deed from Kaufman and Stadler to J. E. O'Connell as an individual (Plff. Ex. 3). So the legal title to the bakery being in O'Connell individually there was no occasion for any deed of transfer by the corporation.

O'Connell, the individual, had new bill-heads printed and used in the business showing that he, the individual, was owning and conducting the business (T. 60, 64, Def's. Ex. 11 and 12).

Purchases were made in the name of J. E. O'Connell, the individual (T. 61).

Taxes were paid in the name of J. E. O'Connell, the individual (T. 61).

The public was advised by O'Connell of the change—"the only thing we knew how to do to inform the people because of the sale; that we were operating as an individual." (T. 61.)

O'Connell, the individual, reported the income from the bakery business in the year 1921 as his individual income for Federal Tax purposes, and paid the income tax. (T. 52, Def's. Ex. 6.)

No formal deed or bill of sale was delivered by the corporation to the individual.

O'Connell states the motive for the transfers was to run the business at a lower cost. (T. 30.)

In 1923 the corporate name was changed to Eddy's Steam Bakery, Inc. (T. 2, 22).

## ARGUMENT

It is not conceivable that anyone can be condemned for legally avoiding taxes. The Revenue Act of 1921 imposed a greater tax upon a corporation in 1921 than upon an individual doing the same business. So that we cannot see how O'Connell owning all the stock of the corporation, or how the corporation, can be condemned as having undertaken an odious thing, when the individual took over the business. We think the court will accept this proposition upon its plain statement, and proceed to the merits.

## JUDGMENT FULLY SUSTAINED BY THE EVIDENCE

The question presented by this appeal is not,—as appellant contends,—whether or not the court below erred in determining what weight should be given to the absence of formal transfer papers from the corporation to the individual, but whether or not there is evidence in the record to sustain the finding and judgment that *the corporation neither earned, nor received, nor acquired, nor was entitled to any income or profits whatsoever for or during the year 1921.*

The case was tried to the court without a jury, and the court's finding of the fact of no income or profits to the corporation cannot be disturbed on appeal if it is supported by substantial evidence.

20 R. C. L. 274, citing 14 State courts;  
5 Enc. Fed. Proc., p. 20, citing 28 Federal decisions.

Brewer, J., in *Walker v. Railroad Co* 165 U. S. 593, 41 L. ed. 837-841, states the rule for overturning a verdict, thus: "When it appears that there was no real evidence in support of any essential fact."

The court below was not trying the question of whether or not title passed, or whether or not O'Connell surrendered his capital stock. The question was whether or not the corporation had—in the words of the Revenue Act—any "gains, profits and income derived from salaries, wages or compensation for person-

al service \* \* \* or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property \* \* \* growing out of the ownership or use of or interest in such property; \* \* \* from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.”

The evidence on this point fully sustains the judgment. The action of the board of directors and stockholders as shown by the minutes (T. 35) clearly shows the purpose to take the corporation out of business. J. E. O’Connell, the President of the corporation, states: “The plaintiff corporation did not transact any business whatever in the year 1921.” And he further states the corporation neither had, or received, nor was entitled to any income or profits for or in the year 1921; (T. 27); in 1921 I operated the Eddy Bakery as an individual by transfer of the assets of the Eddy Bakery, of the O’Connell and Gallivan Company to me as an individual. (T. 29). “I said I was operating as an individual.” (T. 61).

This evidence is not contradicted and fully sustains the judgment.

### **QUESTION OF TITLE ONLY PROBATIVE**

Appellant in his brief cites some 15 cases dealing with the effect of either *assignment of income* or

change and attempted change of operation of a business from corporation to individual stockholder, or from husband to wife. From these it is apparent that the Internal Revenue Department has been endeavoring for years to establish as a rule of *substantive law*, the proposition that title to the corpus establishes title to the income and taxability, but the courts have refused to accept that view. In none of the cases cited is the question of title to the corpus given more than *probative* value.

In eleven of appellant's cases, viz. Ward v. Commissioner, 22 B. T. A. 1108, brief page 27, Wehe v. McLaughlin, 30 F. (2d) 217, brief page 14, Mitchel v. Bowers, 15 F. (2d) 287, brief page 27, Lucas v. Earl, 281 U. S. 111, 74 L. ed. 73, brief page 27, and Leydig v. Commissioner, 43 F. (2d) 494, brief page 27, Alexander S. Brown, 3 B. T. A. 826, brief page 27, Edward J. Luce, 18 B. T. A. 923, brief page 27, L. Brackett Bishop, 19 B. T. A. 1108, brief page 27, Arthur F. Hall, 17 B. T. A. 752, brief page 27, Ward v. Commissioner, 22 B. T. A. 352, brief page 27, and James M. Stubs, Jr., 22 B. T. A. 1386, brief page 27, the effect of the contract considered was to pass title to income *after* it had accrued to the assignor, and *therefore the income was taxable in the assignor before the contract took effect upon it.*

In the Klausner case, 25 F. (2d) 608, brief page 14, the question was whether the income was derived from sale of corporate stock, or liquidation dividend.

The Brunton case, 42 F. (2d) 81, brief page 19, raises only the question of when the sale took effect.

The Capps case, 15 F. (2d) 528, brief page 21, upon which appellant seems to rely, does not touch the question at all. It holds only that the assets of a corporation may be followed into the hands of a transferee to collect tax due from the corporation.

The case Rice-Sturtevant Automobile Co. v. Commissioner, 6 B. T. A. 793, brief page 20, follows the rule for which we contend, viz: that the question of title is only of probative value.

## **O'CONNELL AT ALL TIMES HAS HELD LEGAL TITLE TO BAKERY**

We, of course, have a different situation here than that where the income in question is the increment of the corpus of the property, such as interest from bonds, oil from lands, rental from lands, etc. There the income must first accrue to the owner of the corpus, and, of course, is taxable to him, though there be an assignment. Such assignment could only take effect after the income had come into existence.

Here there is no increment, the income is from selling bread made in the bakery.

And besides *O'Connell has title to the bakery*, the corporation has no title to the bakery, never did have

(Plff's. Exs. 2 and 3). Appellant in his brief urges the proposition that the income follows the corpus, but appellant wholly overlooks the fact that O'Connell, the individual, has title to the bakery.

There is no evidence that this income is the result of any flour, sugar or other bakery supplies on hand December 31, 1920. And as to such personal property, no writing or bill of sale was necessary to transfer title. The mere taking possession by the individual was sufficient.

“A bill of sale is not necessary to make a valid sale of personalty. In fact, it is a matter of common knowledge that the vast bulk of sales of personal property is not accompanied by any written evidence thereof.”

Lewis v. Lambros, 58 Mont. 555-560, 194 Pac. 152; 55 C. J. 535.

## **THEORY IN COURT BELOW**

Appellant assumes the erroneous position that the case was tried below on the question of title.

By paragraph IX of the complaint (T. 5) it is charged that the tax assessment

“is wrongful, unlawful and void, in this that, the plaintiff transacted no business whatever during the calendar year 1921, or any part thereof, and that this plaintiff neither earned, nor received, nor acquired, nor was entitled to any income or

profits whatsoever for or during said calendar year 1921.”

It was upon this theory the case was tried below and judgment entered.

### SUMMARY

We, therefore, have title to the bakery in O'Connell, and we have the finding and judgment of the trial court to the effect that the corporation had no income in the year 1921, and this finding and judgment being supported by substantial evidence, the judgment must be affirmed.

Respectfully submitted,

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December 1931.

